IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	
MICHAEL R. THOMPSON	)	**Case No. 00-00013**
MARTHA A. THOMPSON,	)	
	)	**MEMORANDUM OF DECISION**
Debtors.	)	**AND ORDER**
	)	
	)	
	)	

HONORABLE TERRY L. MYERS, UNITED STATES BANKRUPTCY JUDGE

Howard R. Foley, FOLEY & FREEMAN, CHARTERED, Boise, Idaho, for Debtors.

Gary L. McClendon, Office of the U.S. Trustee, Boise, Idaho.

INTRODUCTION

Chapter 11 debtors in possession, Michael and Martha Thompson ("Debtors" or "Thompsons") have asked the Court to approve their employment of attorneys Howard Foley and Frances Stern ("Attorneys") under § 327(a). The Office of the U.S. Trustee ("UST") objects. The matter came on for hearing pursuant to notice on February 7, 2000 and was taken under advisement following the arguments of Attorneys and the UST. The matter is now ripe for decision, and the Court here enters its findings and conclusions on the Application.

BACKGROUND

On January 3, 2000, Debtors filed a voluntary petition for relief under chapter 11 of the Code. Attorneys were counsel for Debtors at the commencement of the case, and timely filed their Rule 2016(b) disclosure indicating receipt of a $3,000.00 retainer.

Debtors on January 5 filed an Application seeking approval of Attorneys' employment as counsel for them as debtors in possession. The Application avers that:

> [Attorneys] represent no other entity in connection with this case, are disinterested as that term is defined in 11 U.S.C. § 101, and represent or hold no interest adverse to the interest of the estate with respect to the matters on which they are to be employed. They have no connection with Michael R. Thompson and Martha A. Thompson's creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the office of the United States Trustee.

Application at p. 2, para. 5. The Application was accompanied by an affidavit of Mr. Foley which also asserted no other connection with the Debtors or their creditors, professionals or the UST. Fed.R.Bankr.P. 2014(a).

Neither the Rule 2014(a) statement nor the Application disclosed that Attorneys also represented Broadway Market, Incorporated ("Broadway"). Broadway is a corporation solely owned and controlled by Debtors and is itself a chapter 11 debtor in possession before this Court in Case No. 99-00288. Attorneys' employment as professionals in that case was approved by Order entered by Chief Judge Pappas on April 13, 1999.

An Amended Application was filed by Debtors herein on January 18. It states, in pertinent part:

> [Attorneys] represent Broadway Market, Incorporated, a corporation now in Chapter 11 proceedings. The Debtors herein are the principal shareholders in Broadway Market, Incorporated, and the corporation leases real property from the Debtors. T & W Financial Services is a creditor that is common to both the Debtor and to Broadway Market. [Attorneys] represent no other entity in connection with this case, are disinterested as that term is defined in 11 U.S.C. § 101, and represent or hold no interest adverse to the interest of the estate with respect to the matters on which they are to be employed. They have no other connection with Michael R. Thompson and Martha A. Thompson's creditors, any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the office of the United States Trustee.
>
> The Debtors wish to waive any and all conflicts that might be present as a result of [Attorneys'] representation of Broadway Market, Incorporated, in it's [*sic*] Chapter 11 case now on file.

Amended Application at pp. 2 - 3, para. 5, 6. The amended Rule 2014(a) statements are consistent with the assertions of the Amended Application.

Attorneys set the Amended Application for hearing and provided notice to creditors and parties in interest. The UST appeared and voiced its objection to the Application at the scheduled hearing.

The record in Case 00-00013

The schedules filed by Debtors herein reflect the following disclosures and assertions regarding the issue before the Court.

Schedule A of the Debtors asserts fee ownership interests in a residence in Nampa, a business known as the "Melba Laundromat" at 317 Broadway in Melba, and a business identified as "Broadway Market" at 112 4th Street in Melba. Schedule B discloses no

asset interest in any lease or any receivable from any tenant. Nor does it disclose any stockholder or similar interest of Debtors in Broadway. Schedule D reflects security interests in favor of First Security Bank on the Melba Laundromat and in favor of T & W Financial Services Co. on the Broadway Market. On schedule G, Debtors indicated that they had no leases or executory contracts.

Schedule I indicates both Debtors are "employed" by Broadway Market, Inc. as "grocery store managers." It asserts Mr. Thompson receives $5,000 per month, and Mrs. Thompson $250.00 per month, from Broadway as "rental," and Mrs. Thompson also receives what appears to be a monthly wage of $3,600.00 from Broadway.

No reference is made to Broadway's chapter 11 case in the Debtors' statement of affairs or schedules. Nor is it referenced on the Debtors' petition where the petition asks for disclosure of pending bankruptcy cases by any spouses, partners, or affiliates of the Debtors.[1]

That Attorneys knew and understood that there was a relationship between the two chapter 11 cases is manifested by the Amended Application herein, and from an objection they filed to T & W Financial Services' proof of claim. That objection, filed January 27, asserted that a portion of this creditor's claim was really a claim against Broadway and had, at least in part, been valued by Judge Pappas in that case. Their knowledge of the relationship is further evidenced by the record in Case 99-00288, where they served as counsel for Broadway.

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[1] "Affiliate" as defined in § 101(2)(B) encompasses Broadway Market, Incorporated, and the related bankruptcy should have been disclosed.

The record in Case 99-00288[2]

Broadway's case was filed on February 10, 1999. Attorneys were the original counsel for that debtor, and later the approved counsel for Broadway as debtor in possession. Broadway's schedules and statements reflected the Thompsons' ownership of the corporation, but did not disclose the fact that the corporation leased its business premises from the Thompsons.

Budgets provided in the context of motions seeking to use cash collateral, and provided in conjunction with disclosure statements, reflected no lease expense. Neither did the monthly financial reports filed by Broadway. In fact, Broadway's first disclosure statement and plan asserted that it had no leases or executory contracts.

In July, 1999, Broadway amended its schedule A, which previously had indicated no interest in any real estate, to disclose a "leasehold and possessory right and interest in the real property located at 112 4th St., Melba." This assertion was echoed by Judge Pappas in his Summary Order of August 4, 1999 which found that T & W Financial loaned money to the Thompsons to construct the market and that the Thompsons, in turn, leased the premises to Broadway. *Id.*, at 3. An amended disclosure statement in September set forth the inconsistent assertions that Broadway had no leaseholds, and that Broadway had a leasehold interest in the real estate and building on 4th Street in Melba.

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[2] The following information is gleaned from a review of the court file in Case 99-00288. To the extent necessary, the Court takes judicial notice of its own files and records. Fed.R.Evid. 201. *See*, Russell, Bankruptcy Evidence Manual at §§ 201.5, 201.6, p. 303 - 312.

However, Broadway's first amended plan continued to reflect, in its Article Five, that there were no leases.

Immediately before a final hearing on T & W Financial's § 362(d) motion in early January, 2000, Attorneys lodged Broadway's proposed exhibits. These exhibits included a "Lease Agreement" dated December 22, 1999 between Broadway as tenant and Debtors as landlords (the "Lease"). This agreement set forth a $5,000.00 per month rental for a five year term, as well as other obligations and duties of Broadway. A second amended plan was filed on January 13, 2000 with a revised Article Five referring to the Lease. That plan was confirmed at hearing before Judge Pappas on February 15.

Thus, the record establishes that the Debtors are commercial landlords to Broadway.[3] Broadway not only pays wages to the Debtors, it is obligated to pay them rent. The Debtors are also equity holders in Broadway.

The Debtors' filings in this case, No. 00-00013, are incomplete and inadequate. They do not disclose the relationships between themselves and their corporation. This includes the Debtors' failure to disclose their stock ownership in Broadway, or the rights they hold under and by virtue of the Lease.

The initial application and verified 2014(a) statement also failed to disclose the situation, even though the relationship between these two chapter 11 estates was well known both to the Debtors as applicants and to Attorneys. The original verified statements of Attorneys were materially incorrect. So, too, was the Application.

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[3] The Debtors are thus creditors of Broadway given the expansive definitions in §§ 101(10), (12) and (13) of the Code.

This record reflects that Attorneys not only had general knowledge of the relationship between Debtors and Broadway for an extended period, but specific knowledge of the Lease which was entered into in December, 1999, immediately before the Debtors filed the instant case, and immediately before Attorneys filed the original employment pleadings vouching for the absence of any connection with or representation of any interested party.

ISSUE

Before the Court is the question of whether Attorneys may properly be employed as professionals for the Debtors as debtors in possession in this chapter 11 case. Attorneys originally asserted that they did not hold or represent any adverse interests, that they were disinterested, and that they were eligible to be employed as counsel. As noted above, they have filed corrected Rule 2014(a) statements. They disclose their representation of Broadway, but argue that to the extent Broadway is adverse to the Debtors, the Debtors (and, presumptively, their other client, Broadway) "wish to waive" any conflict which exists or may arise. The UST argues that the disqualification of Attorneys as professionals for the estate in this case is absolute.

DISCUSSION

Two separate conditions must be met by a proposed estate professional. First, the professional must himself be a disinterested person. § 327(a); § 101(14). Second, in order to be employed, counsel may not hold "or represent an interest adverse to the estate." §

327(a). *In re Leypoldt*, 95 I.B.C.R. 220, 221 (Bankr. D. Idaho 1995). It is this latter provision which is at issue here.[4]

"Adverse interest" is not specifically defined by the Code, but it includes possession or assertion of an economic interest that would tend to lessen the value of the bankruptcy estate, or possession or assertion of an economic interest that would create either an actual or potential dispute in which the estate is a rival claimant. *Leypoldt*, 95 I.B.C.R. at 222-23, citing *Rome v. Braunstein*, 19 F.3d 54, 58, n.1 (1st Cir. 1994). *See also*, 3 *Collier on Bankruptcy* ¶ 327.04[2][a], p. 327-28 (15th Ed. Revised 1999).

Is there an adverse interest here? *In re Bliss Valley Foods, Inc.*, 88 I.B.C.R. 281, 286 (Bankr. D. Idaho 1988)[5] would indicate there is. The Court there held that counsel could not be approved to represent a corporate debtor in possession while at the same time representing individuals who were both equity security holders and creditors of the debtor by virtue of a lease relationship.[6] There, as here, the lease relationship had not yet

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[4] The UST does not argue that § 327(c) is implicated. That section does not disqualify a person for employment solely because of such person's representation "of a creditor" unless there is an objection by another creditor or the U.S. Trustee, in which case the Court shall disapprove the employment if there is an actual conflict of interest. *See, In re Carr*, 224 B.R. 785, 786, 98.3 I.B.C.R. 84 (Bankr. D. Idaho 1998) (such a situation requires an actual hearing on notice to address the conflict). Rather, the UST's arguments are premised on § 327(a)'s prohibition on employment of counsel who also concurrently represents an "adverse interest."

[5] *See also, In re Bliss Valley Foods*, 89 I.B.C.R. 4, 5-6 (Bankr. D. Idaho 1989) (opinion on denial of motion to alter or amend decision.)

[6] The question often arises whether an attorney can simultaneously represent a chapter 11 debtor corporation and that closely-held corporation's sole shareholders, directors and officers. The converse situation is probably less common, where an attorney seeks to represent individual chapter 11 debtors while also representing their corporation. But the Court does not view this difference in scenario as varying the analysis of the § 327(a) issue.

resulted in actual contested adversity. Nevertheless, the Court found sufficiently adverse interest on both the equity and creditor fronts to require disqualification of counsel. It held that strict adherence to and enforcement of the ethical rules placed on estate professionals is required in order to protect the integrity of the bankruptcy system. 88 I.B.C.R. at 287. *See also, Leypoldt*, 95 I.B.C.R. at 223 (standard should be a strict one.)

The Debtors here are lessor/creditors, as well as the owners, of their tenant corporation. It is not at all difficult to imagine conflicts as the tenant/obligor and landlord/obligee sit across the table from one another and deal with issues related to this lease under the Code and applicable state law, each looking to protect and better its own position.[7] Recall, too, that the creditors of each of these chapter 11 estates look to their debtor in possession as a fiduciary to protect that estate's interests.

That the Debtors or Broadway Market would "consent" to this dual representation or "waive" the conflict is not a cure. The conflict cannot be waived. *See, e.g., In re American Printers & Lithographers, Inc.*, 148 B.R. 862, 867 (Bankr. N.D. Ill. 1992); 3 *Collier on Bankruptcy* at ¶ 327.04[7][a][i], p. 327-56. There exists a disqualifying adverse interest, and, as this Court held in *In re Dugger*, 99.1 I.B.C.R. 30 (Bankr. D. Idaho 1999), it need not weigh, measure or evaluate the degree of conflict or

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The focus is still on whether the proposed attorney also represents an interest adverse to the estate.

[7] For example, assume Broadway defaults and the Debtors forced to pursue collection against Broadway, or that creditors believe they would be better served if this chapter 11 tenant were evicted and another tenant obtained, or that creditors believe $5,000 is a submarket rental. Attorneys could face several issues such as these which might arise in the ordinary course between landlord and tenant.

disinterestedness; its mere existence is enough. 99.1 I.B.C.R. at 32. *See also, Leypoldt,* 95 I.B.C.R. at 223 (distinguishing between "actual" and "potential" conflict is an imprecise and ultimately unnecessary exercise); *First Interstate Bank of Nevada, NA., v. C.I.C. Investment Corporation (In re C.I.C. Investment Corporation*), 175 B.R. 52, 56 (9th Cir. BAP 1994).[8]

Consistent with the foregoing authorities, and the principles set forth in *Leypoldt* and *Bliss Valley*, the Court concludes that the proposed employment here is improper.

CONCLUSION

The burden of proving the absence of an adverse interest, and establishing the propriety of the suggested employment, is upon the applicant and the proposed professional. That burden has not been carried here.[9] The Debtors' request for approval of their employment of Attorneys must be denied since Attorneys are not qualified to be so employed.

ORDER

Based upon the foregoing, the Amended Application for approval of employment of Attorneys as counsel for the Debtors in Possession is DENIED.

Dated this 1st day of March, 2000.

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[8] *See also, In re Occidental Financial Group, Inc.,* 40 F.3d 1059 (9th Cir.1994)*; In re Bonneville Pacific Corp.*, 196 B.R. 868 (Bankr. D. Utah 1996), affd. in part, rev. in part, 220 B.R. 434 (D. Utah 1998); *In re Black Hills Greyhound Racing Assn.*, 154 B.R. 285 (Bankr. D. S.D. 1993).

[9] Attorneys were provided an opportunity to file additional briefing or other submissions following the February 7 hearing in order to support their contention that employment was proper. They have not availed themselves of that opportunity.